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THE WHITE HOUSE
WASHINGTON30 Nov 85
Section 301

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 10/1/85 Number: 317004CA Due By: _____

Subject: Economic Policy Council Meeting -- October 3, 1985

3:00 P.M. -- Roosevelt Room

ALL CABINET MEMBERS	Action	FYI		Action	FYI
Vice President	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>
State	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
Treasury	<input checked="" type="checkbox"/>	<input type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
Defense	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Justice	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Interior	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Agriculture	<input checked="" type="checkbox"/>	<input type="checkbox"/>	McFarlane	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Commerce	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Svahn	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Labor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Chew (For WH Staffing)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HHS	<input type="checkbox"/>	<input type="checkbox"/>	Hicks	<input type="checkbox"/>	<input checked="" type="checkbox"/>
HUD	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Transportation	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Energy	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Chief of Staff	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Education	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	Executive Secretary for:	<input type="checkbox"/>	<input checked="" type="checkbox"/>
CIA	<input type="checkbox"/>	<input checked="" type="checkbox"/>	DPC	<input checked="" type="checkbox"/>	<input type="checkbox"/>
UN	<input type="checkbox"/>	<input type="checkbox"/>	EPC	<input type="checkbox"/>	<input type="checkbox"/>
USTR	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
GSA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
EPA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
NASA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
OPM	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
VA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
SBA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS:

There will be an Economic Policy Council Meeting on Thursday, October 3, at 3:00 P.M. in the Roosevelt Room.

The agenda and background paper are attached.

RETURN TO:

☒ Alfred H. Kingon
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Don Clarey
☐ Rick Davis
☐ Ed Stucky

Associate Director
Office of Cabinet Affairs

THE WHITE HOUSE

WASHINGTON

October 1, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER *EM*

SUBJECT: Agenda and Paper for the October 3 Meeting

The agenda and paper for the October 3 meeting of the Economic Policy Council are attached. The meeting is scheduled for 3:00 p.m. in the Roosevelt Room.

The single agenda item is a review of potential section 301 cases to be initiated by the President. The trade policy review group has developed seven cases for the Economic Policy Council's consideration. A paper outlining the potential cases is attached.

THE WHITE HOUSE
WASHINGTON

ECONOMIC POLICY COUNCIL

October 3, 1985

3:00 p.m.

Roosevelt Room


AGENDA

1. Potential Section 301 Investigations

THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON
20506

October 1, 1985

MEMORANDUM

To: Economic Policy Committee
From: Ambassador Clayton Yeutter 
Subject: Self-initiated Section 301 Cases

Enclosed are summaries of potential section 301 cases for EPC review. These have all been developed by the TPRG, which has recommended the first five for consideration. The TPRG has no recommendation for the next two, but I believe we should fully discuss the airbus situation in light of recent international transactions in that industry.

A number of other cases were discussed too, and rejected for a variety of reasons. A listing of those is attached for your information.

As in our prior meetings, we will wish to evaluate such factors as the flagrancy of the practice, the amount of trade and number of jobs involved, the degree of support from U.S. industry, the duration of the practice, the intensity and duration of U.S. complaints, our international competitiveness, the likelihood of negotiating the elimination or modification of the practice, the impact on Congress of initiation and our political and economic relationships with the country involved.

POTENTIAL SECTION 301 CASES

Tab A: Recommended to the EPC for action:

A.1: Taiwan -- Tobacco, wine and beer monopoly

~~A.2: Korea -- Ban on imports of computers~~

A.3: Korea -- Intellectual property

A.4: Japan -- Aluminum cartel

~~A.5: EC -- Heavy electrical equipment~~

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Tab B: Referred to the EPC for consideration:

~~B.1: France, West Germany, and UK -- Airbus supports~~

B.2: EC -- Export subsidies for wheat and barley *per USTR*

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Tab C: Reviewed by the TPRG, but not referred to the EPC:

Brazil -- General aviation aircraft

West Germany -- Transborder data flow

Canada -- Provincial liquor board practices

Japan -- Regulatory approval practices

Taiwan -- Trade related requirements*

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*The TPRG agreed to consider pursuing this case under Section 307.

TAB A

A.1

TAIWAN -- TOBACCO, WINE AND BEER MONOPOLY

TAIWAN'S TRADE PRACTICE

The Taiwan Tobacco and Wine Monopoly Bureau (TTWMB) controls the importation and distribution of cigarettes, wine and beer. It limits imports to those items not produced in Taiwan or those not produced in adequate amounts to meet domestic demand. This control is implemented through a system of import licenses. Taiwan imposes tariffs of 35-75 percent on tobacco products and applies a 185 percent mark-up to imported cigarettes. Taiwan imposes a tariff of 65 percent on wine and beer, as well as commodity taxes and a TTWMB pricing formula that raises the cost an additional 230 percent (domestic beverages are subject to the same commodity tax rates, but they are assessed on a lower base). Foreign firms are not permitted to advertise cigarettes, beer and wine in Taiwan, although the local products are advertised freely on television and in the printed media.

TRADE EFFECTS

U.S. cigarettes are currently restricted to less than one percent of domestic consumption. In 1984, imports of U.S. cigarettes were valued at \$5.7 million; it is estimated that U.S. cigarettes would capture 25 percent of the market (\$210 million) in the absence of TTWMB quotas, pricing practices and distribution controls.

In 1984 Taiwan imported only 62 metric tons of grape wine and vermouth products from the United States; total imports of such products amounted to 404 metric tons (France and West Germany were the top two suppliers, with the U.S. ranked third). We do not have an estimate of what the U.S. could ship under a freer import regime, but Taiwan has been designated by USTR, in consultation with the industry, as a market with significant market potential for and import barriers to wine; this was done pursuant to the Wine Equity Act. We have scheduled consultations with Taiwan on this issue, as well as the limitations on the sale of cigarettes and beer, for the week of October 7th.

The TTWMB purchased 23.26 million liters of U.S. beer in 1979 and an almost equal amount in 1980. Due to the resemblance of the Rheingold label to a local agricultural chemical, however, sales stagnated (the prohibition against advertising, of course, prevented Rheingold from marketing its product effectively in the local market.) TTWMB cut back its imports by two-thirds in 1981. During the past three years there has been a ban on imports of beer. As with wine, we do not have estimates of U.S. sales in the absence of the TTWMB controls. Nevertheless, there appears to be keen interest on the part of American brewers in penetrating the market. The American Institute in Taiwan reports that six-packs of American beer are the most valued gifts that one can

give to a local citizen.

EVALUATION OF THE PRACTICE

The TTWMB's control of cigarettes, wine and beer imports is so complete that it would meet anyone's standard of an unfair trade practice. In addition, now that Taiwan has begun to export its own beer (China beer) to the United States, the inequity of Taiwan's practices is blatant.

This case would be the ideal one against Taiwan. It would provide an opportunity to open the Monopoly Bureau which has been one of our major market access objectives with Taiwan for at least two years. There is interagency agreement (TPSC 85-80) to seek significant liberalization of the Monopoly Bureau. Also, it would send a message to the Koreans that they should open their wine market soon or face a similar 301.

SECTION 301 CASE -- SUBSTANCE AND PROCESS

The United States has a meritorious claim that Taiwan maintains unreasonable barriers, i.e., discriminatroy treatment of imports and import restraints, against the importation of cigarettes, wine and beer. Such practices are generally prohibited by GATT. Since Taiwan is not a signatory to GATT, it has violated no international rules; however, its behavior can be deemed unreasonable under section 301.

If initiated, this investigation would be pursued bilaterally and would be concluded within one year. At that time, if the problem has not been resolved, USTR would recommend to the President what action he should take. Our leverage to negotiate greater market access with respect to these products rests on our willingness to retaliate by restricting imports from Taiwan if Taiwan does not open its market.

KOREA--BAN ON IMPORTS OF COMPUTERS

KOREAN TRADE PRACTICE

Under its computer decree, Korea has established certain criteria for the issuance of import licenses for computers and peripherals (i.e., printers, terminals, and disk and tape devices) which effectively ban imports of any computers and peripherals of a type made locally.

The objective of the decree is to protect emerging local manufacturers and to attract off-shore computer technology by requiring investment or licensing of local production as a condition for importing. In practice, a foreign supplier must have an approved computer import plan (i.e., approved by a Computer Screening Committee chaired by the Electronic Industries Association of Korea) in order to receive an import license. As a general rule, the plan must include some licensing of Korean firms to produce relevant products.

TRADE EFFECTS

IBM has negotiated an arrangement with Korea that lessens the effect of the decree on its operations. The impact of the restriction is greatest on smaller suppliers and suppliers of small computers, peripherals and parts because such firms do not have the necessary capital or scale of production to license Korean firms. In many cases, they do not manufacture the medium size or large scale computers that Korea is more likely to approve for importation. Even the importation of medium and large scale systems, however, depends on the foreign producer's willingness to transfer technology, produce computer parts locally and provide the know-how for producing plug compatible peripherals. In 1983 -- the year that the restrictions went into effect -- the import market for computers and peripherals was estimated to be \$80 million annually.

The principal U.S. private sector interest in liberalizing the Korean market for small computers is the Computer and Communications Industry Association (CCIA), which is comprised of young, highly innovative firms (predominantly small and medium size firms) that export approximately 40% of their U.S. manufactured products. More than 90% of these firms manufacture all of their products in the United States; as a group, they employ more than 200,000 American workers.

EVALUATION OF THE PRACTICE

Liberalization of the computer decree was a top priority of our 1983 effort to gain greater access to the Korean market. Korea did liberalize imports of mainframes and other large computers effective July, 1984. They did nothing, however, on small computers. There is no justification in economic terms for the strict

licensing procedures used by the Koreans, particularly in light of their willingness to treat some U.S. firms differently than others.

SECTION 301 CASE -- SUBSTANCE AND PROCESS

The United States has a meritorious claim that Korea has violated its GATT obligations by effectively banning the importation of computers and peripherals which are made in Korea. Korea could conceivably invoke the infant industry provisions of the GATT applicable to LDC's; however, even if such provisions were applicable, Korea would still be required to compensate the United States.

If initiated, this investigation would involve dispute settlement in the GATT which could take up to two years to complete.

A.3

KOREA -- INTELLECTUAL PROPERTY

KOREAN TRADE PRACTICES

Korea's inadequate laws on patents, copyrights and trade secrets effectively deny protection to American intellectual property. The combination of inadequate laws and the manner of application of the laws provide a significant impediment to U.S. companies interested in doing business with Korea. According to industry estimates, lost sales of these companies due to inadequate copyright and patent protection could exceed \$200 million annually.

Copyrights protection is available to foreigners only if the work is either first published in Korea or if a treaty requires the protection. Korea does not have such a bilateral treaty with the United States, nor does it adhere to the major international copyright conventions. Even where there is explicit protection, such as criminal penalties for unauthorized duplication of movies and sound recordings, enforcement of the laws is weak and the penalties too small to be effective deterrents. U.S. books, sound recordings and motion pictures are the subject of substantial unauthorized copying. Although the Koreans have promised to amend the existing copyright law, they have been unable to obtain legislative approval for the amendments. In addition, the proposed amendments do not include protection for software, an area of critical importance to the United States.

Korean patent laws also hurt American companies. Certain types of products simply cannot be patented in Korea. These include foods, beverages and medicines. In addition, protection for chemicals and pharmaceuticals is limited to process patents, which is a very weak form of protection. Finally, Korea offers no protection at all for forefront activities such as biotechnology. Korea argues that its current level of patent protection is appropriate for a country at its level of development and that patent protection will be upgraded as Korea becomes more developed. The U.S. view, however, is that Korea already has reached the point at which its intellectual property laws should be upgraded significantly. Several rounds of consultations with the Government of Korea have yielded commitments to improve protection for both copyrights and patents, but to date there has been no change in legislation.

TRADE EFFECTS

It's hard to quantify the actual effects of these policies and practices. Perhaps their greatest impact is in foregone investment by U.S. firms in Korea. Companies are reluctant to introduce their technology rich products into markets where there are no effective controls on misappropriation of the underlying research and development. The Intellectual Property Alliance has made a number of estimates of the economic effects of sales

of unauthorized copies of books, recordings and motion pictures. The Alliance estimates that as much as 60 percent of audio recording sales in Korea were of unauthorized copies. The losses to the U.S. recording industry amount to about \$40 million annually. There are also \$16 million worth of unauthorized sales of motion pictures, and \$20 million in sales of computer software. Unauthorized sales of books, periodicals and journals for another \$80 million per year. Overall, American losses amount to over \$170 million per year because of the absence of inadequate copyright protection alone. Losses from inadequate, or unavailable, patent protection could amount to again as much.

EVALUATION OF THE PRACTICE

The Korean government has failed to adopt policies or enact laws that would provide reasonable protection. We have had ongoing consultations at the technical and policy levels, but the Koreans thus far have not responded as positively on these issues as have Taiwan, Singapore and Hong Kong. A Section 301 may focus the Korean's attention in a way we have not yet been able to do. In addition, a 301 would send a strong signal to other countries in the region that the Administration was carrying out the President's commitment to increase the effort to protect American intellectual property.

One consideration in evaluating this case is that there already are two Section 301 investigations against Korea - the Administration's self-initiated case on insurance and the Motion Picture Export Association's case on motion pictures.

SECTION 301 CASE -- SUBSTANCE AND PROCESS

Korea has not violated any international rule in limiting the protection it affords to intellectual property rights. Nevertheless, the President is authorized under section 301 to act against practices which he deems unreasonable. Inadequate protection of intellectual property rights clearly can be encompassed by the term "unreasonable."

If initiated, this case would be pursued bilaterally and would be concluded within one year. At that time, if the problem has not been resolved, USTR would recommend to the President what action he should take. Our leverage to negotiate greater protection of intellectual property rights rests on our willingness to retaliate by restricting imports from Korea if Korea does not resolve this matter.

JAPAN - ALUMINUM CARTEL

JAPANESE TRADE PRACTICE

Pursuant to a special law for the structural improvement of industries, Japan has designated the aluminum fabricating industry as requiring structural adjustment. While the GOJ does not concede that it has created a cartel, the industry is authorized, subject to specific MITI and Japan Fair Trade Commission (JFTC) approval, to reduce capacity and control investment.

One purpose of the plan is to reduce substantially high-cost domestic smelting capacity. This may have been effected through subsidized loans. This capacity reduction has led to substantial increases in Japanese imports of ingot. However, because Japan grants preferential tariff treatment to ingots imported by Japanese smelters (many of whom are related to the aluminum fabricators), U.S. exporters have not shared in this growing import market. In fact, U.S. ingot exports have decreased.

Under the plan for the aluminum industry (which has been approved by MITI and JFTC and is in effect through 1988), the companies agree with MITI on demand and supply forecasts, joint research is permitted, mergers are officially encouraged, and joint buying and selling may be permitted (it is not known whether this latter activity is occurring now).

TRADE EFFECTS

U.S. exports of ingot have fallen despite increased Japanese demand for imported ingot. U.S. exporters currently have less than 1% share of Japan's fabricated product market. Japanese aluminum exports to the U.S. have increased significantly during the 1973-83 period.

EVALUATION OF THE PRACTICE

The United States has a meritorious claim that Japan's preferential tariff treatment is inconsistent with GATT. The subsidies may also be GATT inconsistent if they have seriously prejudiced U.S. interests. Japan's cartel practices are not covered by the GATT. However, if we can demonstrate that the cartel allows Japanese firms to engage in anticompetitive behavior which denies access to U.S. exports, it can be deemed unreasonable under Section 301. We need further information before we can definitively evaluate the merits of this aspect of the case. This could be developed during the investigation.

SECTION 301 CASE -- SUBSTANCE AND PROCESS

Because of the existence of GATT and non-GATT issues, the case can only be handled comprehensively through a non-GATT bilateral

approach. However, we have the option of invoking the GATT dispute settlement mechanism for the GATT issues while pursuing the other issues bilaterally if we choose. If the latter option is selected, the investigation will take longer to complete because of the time necessary to finish the GATT process.

EC--HEAVY ELECTRICAL EQUIPMENT

ISSUE

Purchases of heavy electrical equipment in Europe are dominated by government owned or state controlled utilities which follow restrictive buy national procurement policies that effectively curtail U.S. export potential. These government entities are not covered by the Government Procurement Code.

EUROPEAN TRADE PRACTICES

The heavy electrical equipment industry is highly concentrated and oligopolistic in structure. The capital intensity, long term horizons, high risks associated with developing new technical systems, and the cyclical nature of the industry have led to a limited number of suppliers in this industry. Purchases of heavy electrical equipment in most major developed countries are dominated by government owned or controlled utilities. These utilities, for the most part, follow buy national procurement policies. In those countries where the market is divided among state and privately owned utilities, the private firms generally procure domestically. U.S. industry representatives argue that in these cases opening the state controlled market would lead to increased sales to the privately owned firms as well.

The major European manufacturers have restrictive licensing arrangements among each other. Some evidence suggests that the concentration of the heavy electrical equipment industries in Western Europe is not the result of normal market forces but instead the result of a conscious policy by the respective governments to consolidate the industry. The award of contracts, encouragement of mergers, provision of low interest financing, subsidization of export sales and two-tier pricing systems have all operated to exclude U.S. firms from the European market.

While discriminatory procurement practices are widespread in Europe, key target countries should include the U.K. and France.

TRADE EFFECTS

Significant sales to third country markets of heavy electrical equipment support the industry's contention that U.S. firms would capture a share of the European market in the absence of buy national practices. Given the size of this market, even a modest share would be important in value terms. For example, even a 15 percent market share for one product area--large power transformers--would have resulted in an additional \$50 million of U.S. exports to Europe annually for the period 1980-85. In the case of turbine and turbine generators, the industry estimates that a 15 percent share would yield an additional \$60 million annually in exports to Europe for the period 1987-91. While it is difficult to estimate potential market share when

those markets are virtually closed at present, a market share of 15 percent is considered to be a reasonable estimate and would be attainable within current production capacity of U.S. industry.

EVALUATION OF THE PRACTICE

Although the Administration is continuing to press for coverage of these government owned or state controlled utilities under the GATT Government Procurement Code, the prospects are not hopeful. In the absence of unilateral opening of the European market, U.S. firms will continue to suffer from the lack of equivalent competitive access to world markets and foreign suppliers will enjoy higher prices in their home markets than those realized on competitive export markets.

SECTION 301 CASE -- SUBSTANCE AND PROCESS

Although the U.S. has clearly suffered economically from the EC procurement practices, our case against the EC is legally weak. Not only have the EC countries not violated any international rules in procuring their heavy electrical equipment domestically, they have acted consistently with an explicit GATT provision which permits such practices. Our aim in pursuing this issue would be to bring government owned or controlled utilities under the disciplines of the Government Procurement Code. However, if we are unsuccessful, we would need to consider whether to retaliate against the EC.

If initiated, this investigation would be pursued bilaterally and would be concluded within one year.

TAB B

AIRBUS GOVERNMENT SUPPORTS

B.1

AIRBUS GOVERNMENTS' PRACTICES

*go to gatt -
rather than 301?*

The Airbus Member Governments (France, West Germany, and the United Kingdom) are subsidizing the development and production of Airbus aircraft. These government support practices enable Airbus to not only slash prices in sales campaigns but allows Airbus to embark upon new program development without first recouping the costs of previous programs. U.S. aircraft manufacturers are finding it increasingly difficult to compete against a government-supported foreign aircraft industry.

Airbus has captured 19 percent of the total market for large jet transports between 1980 and 1984 (or sales of \$8.5 billion) and 10 percent of the market during the first six months of 1985. These latter figures do not take into account recent major procurements of Airbus aircraft by Lufthansa and Indian Airlines.

Foreign government support of the development, production and marketing of commercial transports challenges the market share and production activity of private U.S. firms and alters the perceptions of these firms concerning future aircraft marketing. Airbus' greatest market advantages, resulting from the extensive subsidization, are in the areas of pricing and launching of new programs without consideration of recoupment of costs.

Participating Airbus Governments (France, West Germany, and the United Kingdom) have provided Airbus Industrie with funds estimated at \$4.6 billion for the design and development of the A-300, A-310 programs, and approximately \$1.6 billion to fund the A-300, A-310 plant and equipment costs. In 1982, the FRG suspended indefinitely the recoupment of nearly \$1 billion in previous development fund guarantees to Deutsche Airbus. The A-320 was launched in 1984 with approximately \$1 billion in support.

EVALUATION OF THE PRACTICE

The GATT Agreement on Trade in Civil Aircraft, which delineates the rules governing commercial aircraft activities including government supports, cross references the disciplines of the Subsidies Code. While domestic subsidies are not prohibited, parties have agreed to use such subsidies only in a manner that will not adversely affect the trade interests of another signatory.

The GATT Aircraft Agreement also requires that signatories price aircraft based on a reasonable expectation of recoupment of all costs, including non-recurring program costs, identifiable and pro-rated costs of military research and development on aircraft, components, and systems that are subsequently applied to the production of such civil aircraft, average production costs, and

financial costs. With the substantial price slashing that is occurring with Airbus aircraft sales, it is difficult to believe that prices are being based upon these criteria.

SECTION 301 CASE -- SUBSTANCE AND PROCESS

Under GATT rules, the EC is permitted to subsidize the production of goods provided that the subsidies do not cause serious prejudice to the interests of other GATT signatories. "Serious prejudice" is a vague concept. It is not at all clear that we could obtain such a finding if we took this case to the GATT.

We can pursue this issue in the Subsidies Code; indeed, the EC may argue that our international obligations require us to do so before we can take action against the EC; however, there is little likelihood of a conclusive result in GATT on this matter. Alternatively, the investigation could be handled bilaterally with the Airbus Member Governments in which case it would be concluded within one year. Our leverage to negotiate a solution rests on our willingness to retaliate unilaterally if the EC does not adjust its policies.

EC -- EXPORT SUBSIDY ON WHEAT AND BARLEY

B.2

EC TRADE PRACTICE

By the use of direct export subsidies, the European Community has dumped surplus grain onto the world market. These subsidies are increased whenever necessary and are larger for more distant destinations, such as China. Incomes and price levels for grain producers within the Community are protected at levels well above the market. In contrast to the United States, qualification for such supports has required no cutback of acreage in the EC. Thus, the surplus has grown and grain from the United States and other exporting countries has been displaced at will by the export subsidy mechanism. The EC wheat and barley export subsidy not only allows EC grain to displace U.S. grain on world markets, but it also tends to lower the level of world price.

ILLEGIB

TRADE EFFECTS

Globally, the EC share of world wheat and barley trade has expanded steadily, as shown by the attached data. Currently, one example of competition for U.S. grain from subsidized EC wheat and barley is the USSR market, where EC shipments have risen sharply in recent years to a 1984/85 level of about 9 MMT. The trade impact of this practice involves both a quantitative loss of U.S. exports and additional losses resulting from lower world price. Whereas the quantitative impact accrues entirely to the United States as a residual supplier, the price impact is shared by other exporting countries; also the price impact applies to domestic as well as export marketing.

Without export subsidies, total EC grain exports to all third countries would probably be 10 million tons less. If those subsidies were discontinued now, in the midst of global oversupply situation for grains, EC exports--which now account for over 20 MMT per year--might even stop entirely.

Assuming 10 MMT less grain exports from the EC, current world grain prices would be an estimated \$10 higher per metric ton. The current total trade impact on the United States is therefore estimated at \$2 billion per year; half of this is the quantitative impact (10 MMT x \$100 per metric ton), and the other half is price (\$10 per metric ton x total U.S. grain exports of 100 MMT). The trade impact on other exporting countries represents another \$1 billion (100 MMT x \$10 per metric ton). The domestic impact aspects are even broader. A price difference of \$10 on total U.S. grain production of 300 MMT represents \$3 billion annually that is being made up by deficiency payments, storage costs, loans, etc.

EVALUATION OF THE PRACTICE

The EC argues that they have not taken an unfair portion of world trade, but the percentage has increased steadily over the past 20 years. The aggravation from the EC subsidies presently is even greater because of their major increases in shipments to the USSR and Eastern Europe. A program to meet this unfair practice would cause the EC's cost of managing their grain surplus to rise sharply. Offsetting increases in sales to other markets would not be practicable because the subsidy costs would tend to "snowball". Storage, the other main alternative, would also be costly.

Meeting this unfair EC practice might tend to lower world prices for grain in general. This would benefit many LDC countries who are grain importers.

It might also have adverse effect on non-subsidizing exporter countries, but this will happen to them anyway if U.S. loan rates are modified beginning with 1986.

SECTION 301 CASE - SUBSTANCE AND PROCESS

Under GATT rules, the EC is permitted to subsidize the export of primary agricultural products such as wheat and barley provided that the EC does not take more than an equitable share of the world market for these products as a result of the subsidies. These rules are extremely vague and virtually inoperable. There is no reason to believe that we could win this case if we took it to the GATT. However, we remain convinced that but for its subsidies EC exports of grain products to the world market would be substantially less. Pursuing this case is consistent with our goal of obtaining more discipline on the use of subsidies in the agricultural sector; however, any action we take which challenges the CAP will have strong immediate repercussions in the EC. The repercussions will be all the greater because we are considering unilateral retaliation in this case.

If initiated, this case would be handled bilaterally and would be concluded within one year. If we have not resolved the issue by that time, USTR would recommend to the President what action he should take.

USDA Submission

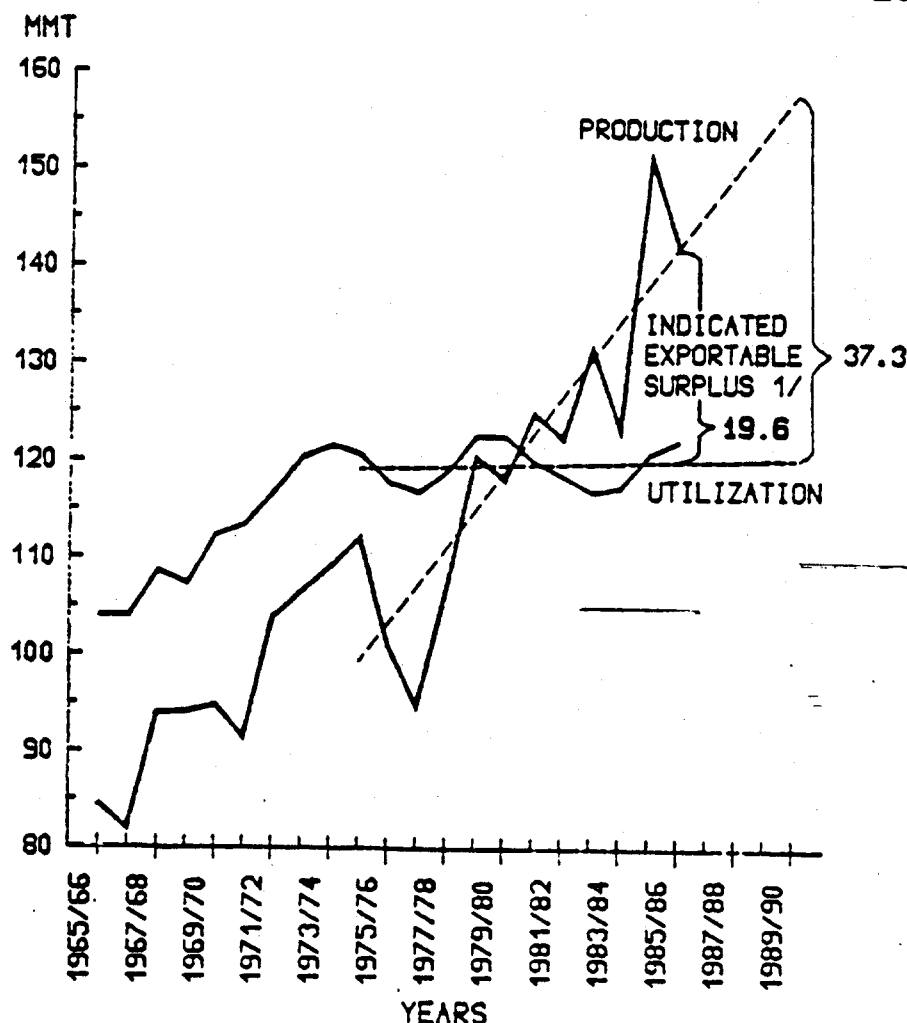
EC Exports of Wheat and Barley
Compared to Total World Trade

	<u>EC</u>		<u>World Total</u>
	<u>Volume</u>	<u>Share of</u>	<u>(MMT)</u>
	<u>(MMT)</u>	<u>World Total</u>	
		<u>(%)</u>	
1970/71-72/73 Ave	7.0	10.2	68.7
1983/84	19.2	16.2	118.3
1984/85	24.5	19.4	126.3
1985/86 (forecast)	23.0	20.7	111.3

This graph highlights the EC's increasing challenge to traditional grain exporting countries. Over the past 10 years EC grain production has increased dramatically at the same time as utilization has stagnated. Viewed in terms of a trend line, with yearly fluctuations removed, the indicated EC total grain exportable surplus rises from a present level of 19.6 MMT to 37.7 MMT by 1989/90. This represents a growth rate of about 4 MMT annually, which is double the average growth rate of total world grain trade between 1960 and 1985.

The growing exportable surplus has serious ramifications for the EC and traditional exporting countries. If such surplus is exported, especially into a highly competitive market, the costs for the EC export subsidy program could soon approach \$2 or \$3 billion yearly. The economic impact on traditional and non-subsidizing export countries, which already represents billions of dollars, would be even larger. On the other hand, if the surplus is not exported, costs of storage and/or production limitations will also become very heavy for the EC.

EXPANDING EC WHEAT AND COARSE GRAIN SURPLUS



1/ The difference between extrapolations of trend lines calculated for the 1974/75-1985/86 base period.

TAB C

Cases Rejected by the TPRG

FRG - Transborder Data Flow

Initiation of an investigation is inappropriate at this time because the U.S. and FRG will consult on this issue shortly. Moreover, much of the data involved in this case relates to banking services. Initiation of an investigation would complicate the handling of international banking issues.

Brazil - General Aviation Aircraft

Initiation of an investigation could jeopardize sales of U.S. helicopters and large aircraft to Brazil. The U.S. has several other unfair trade practice complaints against Brazil pending now: 301 on informatics, antidumping and countervailing duty cases.

Canada - Provincial Liquor Board Practices

U.S. industry is split on support for this case. Prospects for resolution appear slim unless the issue is folded into free-trade agreement discussions. Canadian restrictions are provincial, not federal; the case, therefore, raises states' rights questions.

Japan - Regulatory Approval Procedures

Since this issue is under discussion in the MOSS talks, it would be inappropriate to initiate a 301 investigation.

Taiwan - Trade Performance Requirements

Initiation of an investigation is premature; we should look for better cases on trade related performance requirements. Sec. 307 of the Trade and Tariff Act of 1984 provides another mechanism for dealing with export performance requirements.